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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 118

FOOD MACHINERY AND CHEMICAL CORPORATION, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

SUPPLEMENTAL BRIEF FOR THE UNITED STATES IN OPPOSITION

This memorandum is filed pursuant to the Court's request of October 5, 1961, that the government respond to the taxpayer's reply brief submitted in support of its petition for a writ of certiorari.

1. The essence of taxpayer's reply brief is that (p. 5) the decision of the Court of Claims in this case "is in conflict with the accrual rules recently laid down by this Court during the October, 1960, term." Specifically, the reply brief refers (p. 11) to the following cases: *American Automobile Assn.* v. *United States,* 367 U.S. 687; *United States* v. *Consolidated Edison Co.,* 366 U.S. 380; and *Commissioner*

v. *Milwaukee & Suburban Transport Corp.*, 367 U.S. 906, vacating and remanding 283 F. 2d 279. None of those cases, we submit, in any way impairs the well-settled rule of annual tax accounting, as applied to taxpayers on the accrual basis, that an item of gross income is accruable in the year the taxpayer's right to the income becomes fixed, and the amount of the income becomes reasonably ascertainable. *Continental Tie & L. Co.* v. *United States,* 286 U.S. 290; *Spring City Co.* v. *Commissioner,* 292 U.S. 182, 184–185; *Commissioner* v. *Hansen,* 360 U.S. 446, 463–464. To the contrary, each of those cases represents an affirmative application of the basic annual accounting rule, or of its equally well-settled corollary, that an item must be deducted by an accrual basis taxpayer in the year his liability to pay becomes fixed, and the amount of the liability can be reasonably ascertained. *United States* v. *Anderson,* 269 U.S. 422, 437–438, 440–441; *Lucas* v. *American Code Co.,* 280 U.S. 445, 449–450; *Brown* v. *Helvering,* 291 U.S. 193, 200; *Dixie Pine Co.* v. *Commissioner,* 320 U.S. 516, 519; *Security Mills Co.* v. *Commissioner,* 321 U.S. 281, 286–287.

The court below correctly applied those established principles to the facts of this case. It held that since the taxpayer had acquired during the taxable year (fiscal 1945) a fixed right to receive compensation by reason of the termination of its war contracts, and since the amount receivable had also become reasonably ascertainable before the end of that year, it was required to accrue and report the income in that year, not in some later year. Contrary to taxpayer's

assumption, in so holding the court below did not depart from accrual principles recently reaffirmed by this Court in *American Automobile Assn.*, *Consolidated Edison*, and *Milwaukee & Suburban*.

Taxpayer's mistaken reliance upon *American Automobile Assn.* and related cases stems from its confusion of two distinct (albeit component) factors entering into a determination of the accruability in a given taxable year of an item of gross income or deduction: (1) whether the right to receive (an income item) or the liability to pay (a deduction item) became fixed during the taxable year; and (2) whether the amount receivable or payable was also reasonably ascertainable during the taxable year. The second inquiry is not reached, of course, unless the first is answered in the affirmative; for even though the amount of a contingent right or liability is known, the fact that the right or liability remains contingent during the taxable year in and of itself precludes accrual for tax accounting purposes.

American Automobile Assn., *Consolidated Edison*, and *Milwaukee & Suburban* each involved attempts to offset against or deduct from gross income contingent liabilities—*i.e.*, anticipated expenses, liability for which had not yet become fixed in fact during the taxable year—and in each case it was held that the liabilities had not yet ripened into deductible expenses of the taxable year.[1] Here, on the other hand, as the

[1] In *American Automobile Assn.*, the contingent liabilities consisted of estimated expenses for future services which the taxpayer might be called upon to perform for its members subsequent to the taxable year. In *Consolidated Edison*, they

court below found (Pet. 40) and the taxpayer concedes (Pet. 31, 33; Reply Br. 6–7), the taxpayer had a fixed right to receive some amount of compensation on account of the government's termination of the contracts; the only issue, to which the court below properly addressed itself, was whether the amount receivable could be determined with reasonable accuracy. On the basis of all the evidence it found that by the end of the taxable year settlement negotiations had proceeded to the point where the amount which the taxpayer had a fixed right to receive was reasonably ascertainable.[2] Applying accrual accounting principles enunciated by this Court in *Continental Tie & L. Co.* v. *United States, supra,* and repeatedly reaffirmed by this Court (*e.g., Spring City Co.* v. *Commissioner, supra; Security Mills Co.* v. *Commissioner,*

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consisted of real estate tax claims paid by the taxpayer under protest but still being contested during the taxable year. In *Milwaukee & Suburban*, they consisted of an estimated amount payable in satisfaction of accident claims which were still being contested during the taxable year.

Commissioner v. *Fifth Avenue Coach Lines, Inc.*, 281 F. 2d 556 (C.A. 2d), certiorari denied, 366 U.S. 964, upon which taxpayer also relies (Reply Br. 12), likewise involved the deductibility of a contested liability—interest on a judgment which had not yet become final during the taxable year.

[2] The taxpayer conceded below (Pet. 33) and again concedes here (Reply Br. 6-7) that upon termination of the contracts it acquired a fixed right to receive "something," and the dispute accordingly centered on whether the amount receivable could be ascertained with reasonable accuracy. After carefully analyzing the evidence (Pet. 23–39), the court below concluded that (Pet. 40) "under the facts and circumstances of this case, negotiations between the parties had reached a stage of sufficient agreement by the end of fiscal 1945 for the amount of plaintiff's profit allowance to be considered reasonably ascertainable at that time."

supra; Commissioner v. *Hansen, supra*) it correctly held that the amount was accruable as income in the taxable year. There is nothing in this Court's opinions in the *American Automobile Assn.* and related cases, or, for that matter, in any of this Court's other opinions applying the annual accounting rule and corollary accrual principles, which in any way detracts from the correctness of the decision below.

In *American Automobile Assn.* v. *Commissioner, supra,* the gross income in question (annual membership dues) had in fact been received by the taxpayer during the taxable year. The only question was whether the taxpayer—despite its actual receipt and control of a known amount of income—could nevertheless "defer" accruing and reporting a portion of the income to a subsequent taxable year when it expected to incur certain allegedly related expenses. Applying the "annual accounting" rule, the Court held (pp. 690–692) that deferral of the income was improper because the taxpayer's liability to pay the claimed offsetting expenses had not become fixed during the taxable year but remained contingent. The Court pointed out (pp. 692–694) that a reasonable estimate of the future expenses "on a group or pool basis" did not suffice to transform what were otherwise individual contingent liabilities into fixed ones, and therefore concluded that admittedly contingent individual expenses could not be accrued. In this case, petitioner's right to the income was not contingent in the year in which the court below held that it accrued, and there is nothing in the *American Automobile Association* case which bears upon whether the amount was sufficiently ascertainable.

Taxpayer's reliance on *Consolidated Edison Co., supra*, is similarly misplaced. There, the taxpayer was contesting a local real estate tax which it had paid under protest as the only means of securing judicial review of the valuation on which the tax was based, and as the only means of avoiding interest, penalties, and the seizure and sale of its property. The government contended that inasmuch as the taxpayer had in fact paid the taxes assessed, and thus satisfied its liability therefor, it should be required to deduct (*i.e.*, accrue) that liability on its return for the year of payment even though the taxpayer's ultimate liability for the tax remained a matter of dispute. The Court rejected this contention, holding (pp. 391-392) that the taxpayer's "payment" amounted to "a mere deposit," and therefore that the disputed liability was properly accruable only in the later year when all the events had occurred finally to determine the dispute, *viz.*, in 1951 when the state court's order fixing taxpayer's liability became final. See also *Commissioner* v. *Fifth Avenue Coach Lines*, 281 F. 2d 556 (C.A. 2d), certiorari denied, 366 U.S. 964. Thus the only question affected by *Consolidated Edison* is the effect of a cash payment or cash receipt in advance of the normal time for accruing an income or liability item. The instant case does not involve such a question, and nothing in *Consolidated Edison* suggests any departure from the previous accounting standards for determining when a liability or income item should be accrued.

Finally, in *Commissioner* v. *Milwaukee & Suburban Transport Corp., supra*, vacating and remanding 283 F. 2d 279 (C.A. 7th), an accrual basis taxpayer de-

ducted the amount which it estimated to be its potential liability on unsettled accident claims. On none of the claims did the taxpayer admit liability. In fact, the taxpayer was vigorously contesting many of the claims in court. The Tax Court, in a memorandum decision dated November 18, 1959 (1959 P-H T.C. Memorandum Decisions, par. 59,216), sustained the Commissioner's disallowance of the deduction, finding (a) that "the existence of petitioner's liability respecting the unsettled claims of each year did not become definitely fixed during such year"; and (b) that "the amount of petitioner's liability in respect of unsettled claims of each year was not ascertainable within such year, with reasonable certainty." The Court of Appeals reversed, holding that because the accidents giving rise to the claims had occurred by the year's end, all the events had occurred which established liability; the fact that taxpayer was contesting each individual claim was not deemed controlling. Furthermore, on the issue of reasonable ascertainability of the amount of liability, the Court of Appeals disagreed with the Tax Court, holding that even though none of the claims could be individually evaluated, they could be estimated in the aggregate (or on a group or pool basis) with a fair degree of accuracy. However, this Court (367 U.S. 906) remanded the case to the Seventh Circuit in the light of *American Automobile Assn.* and *Consolidated Edison*, and upon the remand, the Seventh Circuit vacated its prior decision and affirmed that of the Tax Court. 61-2 U.S.T.C. par. 9653. In no sense can this disposition of the *Milwaukee & Suburban* case be regarded

as a rejection or modification of the established accrual rules.

As the foregoing analysis shows, none of the accrual accounting decisions rendered by this Court during the October Term, 1960, "conflicts" (Reply Br. 5) with the accrual rules established by the earlier decisions of this Court, particularly *Continental Tie & L. Co.* v. *United States*, 286 U.S. 290.

2. There is no merit in taxpayer's argument (Reply Br. 11–15) that the "all events" test followed by this Court in *Consolidated Edison Co.* contemplates something more than a fixed right to receive a reasonably ascertainable amount of income in order to require accrual.[3] The opinions of this Court in *Lucas* v. *American Code Co.*, 280 U.S. 445, and *Continental Tie & L. Co.* v. *United States*, 286 U.S. 290, establish that mathematical certitude is not essential to accrual. See, also, *Brown* v. *Helvering*, 291 U.S. 193.[4] Taxpayer's attempt (Reply Br. 7–8) to distinguish the *Continental Tie* case on the ground that the amount involved

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[3] Taken to its logical extreme, taxpayer's interpretation of the all events test would effectively postpone accrual until the amount of a fixed liability (or right to income) is established down to the last penny.

[4] In the *Brown* case, this court stated (p. 200) that

> * * * where a liability has "accrued during the taxable year" it may be treated as an expense incurred; and hence as the basis for a deduction, although payment is not presently due. *United States* v. *Anderson*, 269 U.S. 422, 440, 441; *American National Co.* v. *United States*, 274 U.S. 99; *Aluminum Castings Co.* v. *Routzahn*, 282 U.S. 92; and although the amount of the liability has not been definitely ascertained. *United States* v. *Anderson*, *supra*. Compare *Continental Tie & Lumber Co.* v. *United States*, 286 U.S. 290, 296.

there required "only a computation", whereas the amount involved in the instant case required "negotiation", is unavailing. Thus, in *Lucas* v. *American Code Co., supra*, p. 450, this Court recognized that a loss from breach of contract would be deductible by an accrual basis taxpayer "where, within the tax year, there is a definite admission of liability, negotiations for settlement are begun, and a reasonable estimate of the amount of the loss is accrued on the books." Similarly, taxpayer here was required to accrue income for the taxable year in question because the right thereto became fixed upon termination of the contracts, negotiations for settlement had begun, and the amount of the income was ascertainable with reasonable accuracy. The fact that negotiations are required to fix the precise amount of a settlement may well be an important consideration in determining whether or not an amount is reasonably ascertainable, but it certainly does not preclude an affirmative finding in that regard. In the instant case, the Court of Claims took all the facts into account, including the negotiations, and found on the evidence as a whole that taxpayer's right to income was reasonably ascertainable in amount. This finding is fully supported by the record and should not be disturbed.

3. Taxpayer's unsupported and belated assertion (Reply Br. 6) that its right to fair compensation did not become fixed during the taxable year in question is completely inconsistent with its admission (Reply Br. 6–7) that it had the right to receive "something" on termination of its contracts, *i.e.*, that it had an "unliquidated claim * * * against the

Government for fair compensation." At no time did the government contest or in any way deny taxpayer's right to fair compensation under the Contract Settlement Act. To the contrary, both contracting parties recognized, assumed, and admitted that taxpayer had such right when the contracts were terminated, the only unresolved question being the precise amount of the compensation to be paid. Cf. *Consolidated Edison Co., supra,* where taxpayer contested its liability to pay any additional taxes. As demonstrated in our Brief in Opposition (pp. 10–12), as held by the Court of Claims, and as clearly indicated by the evidence, the amount of compensation, while not determined with precision as of the close of the taxable year, was nevertheless ascertainable with reasonable accuracy. Hence, under established accrual rules, it was properly includible in gross income for that year.

For the reasons stated above, and the additional reasons set forth in the Government's Brief in Opposition, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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